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Department of the Treasury
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Person To Contact:
, ID No.

Telephone Number:

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Date:
September 06, 2019

LEGEND

X =

A =

B =

Trust 1=

Trust 2=

Date 1=

Date 2=

Date 3=

Date 4=

Date 5=

Date 6=

Date 7=

State =

Dear _____ :

This responds to a letter dated February 27, 2019, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted and representations within, X was incorporated on Date 1 under the laws of State, and elected to be taxed as an S corporation effective Date 2.

A and B, a married couple, owned shares in X. On Date 3, A died. On Date 4, A's shares in X were transferred to Trust 1 and Trust 2, each a testamentary trust. X represents that Trust 1 and Trust 2 were eligible to make Qualified Subchapter S Trust (QSST) elections as of Date 4. However, B, the beneficiary of Trust 1 and Trust 2 failed to file a timely QSST election for Trust 1 and Trust 2, thereby causing X's S corporation election to terminate effective Date 5.

On Date 6, B died. X represents that upon B's death, Trust 1 and Trust 2 were to convert from QSSTs to Electing Small Business Trusts (ESBTs). X represents that Trust 1 and Trust 2 met the requirements to qualify as ESBTs effective Date 7. However, the trustees and beneficiaries of Trust 1 and Trust 2 failed to file timely ESBT elections for Trust 1 and Trust 2 effective Date 7.

X represents that Trust 1 and Trust 2 have qualified as QSSTs under § 1361(d) at all times from Date 4, the date that each trust first acquired stock in X, to Date 7, the date that each trust should have converted to an ESBT. X represents that Trust 1 and Trust 2 filed consistently as if valid QSST elections were in place from Date 4 to Date 7. X represents that Trust 1 and Trust 2 have qualified as ESBTs since Date 7. X represents that X and its shareholders, including Trust 1 and Trust 2, will amend their returns consistent with the treatment of Trust 1 and Trust 2 as ESBTs from Date 7 and thereafter.

X represents that the circumstances resulting in the failure to file QSST and ESBT elections were inadvertent and not motivated by tax avoidance or retroactive tax planning. X further represents that X has filed its income tax returns consistent with having a valid S election in effective for all taxable years since X elected to be an S corporation. X represents that other than the failure to make valid QSST elections on Date 4, and valid ESBT elections on Date 7, X has qualified as a small business corporation at all times since Date 2. Finally, X and its shareholders agree to make any adjustments required as a condition of obtaining relief under § 1362(f) that may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) of the Code provides that for purposes of section 1361(b)(1) a trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(C)(2)(A)(iii) provides that for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to a will may be a shareholder, but only for the two-year period beginning on the day on which such stock is transferred to it.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means a trust (A) the terms of which require that – (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1361(e) provides that an ESBT means any trust if (i) such trust does not have

as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or was terminated under § 1362(d) or (3) or § 1361(b)(3)(C); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the QSST election by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii)(A) provides that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1.1361-1(j)(6)(iii)(E) provides that if a corporation's S election terminates because of a late QSST election, the corporation may request inadvertent termination relief under § 1362(f).

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust

that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1.1361-1(j)(12) provides that, for a trust that seeks to convert from a QSST to an ESBT, the consent of the Commissioner is hereby granted to revoke the QSST election as of the effective date of the ESBT election, if all the following requirements are met: (i) the trust meets all of the requirements to be an ESBT under § 1.1361-1(m)(1) except for the requirement under § 1.1361-1(m)(1)(iv)(A) that the trust not have a QSST election in effect.; (ii) the trustee and the current income beneficiary of the trust sign the ESBT election. The ESBT election must be filed with the service center where the S corporation files its income tax return. This ESBT election must state at the top of the document "ATTENTION ENTITY CONTROL – CONVERSION OF A QSST TO AN ESBT PURSUANT TO SECTION 1.1361-1(j)" and include all information otherwise required for an ESBT election under § 1.1361-1(m)(2). A separate election must be made with respect to the stock of each S corporation held by the trust.; (iii) the trust has not converted from an ESBT to a QSST within the 36-month period preceding the effective date of the new ESBT election.; and (iv) the date on which the ESBT election is to be effective cannot be more than 15 days and two months prior to the date on which the election is filed and cannot be more than 12 months after the date on which the election is filed. If an election specifies an effective date more than 15 days and two months prior to the date on which the election is filed, it will be effective on the day that is 15 days and two months prior to the date on which it is filed. If an election specifies an effective date more than 12 months after the date on which the election is filed, it will be effective on the day that is 12 months after the date it is filed.

Section 1.1361-1(m)(1)(i) provides, in relevant part, that an electing small business trust means any trust if it meets the following requirements: the trust does not have as a beneficiary any person other than an individual, an estate, an organization described in section 170(c)(2) through (5), or an organization described in section 170(c)(1) that holds a contingent interest in such trust and is not a potential current beneficiary; no interest in the trust has been acquired by purchase; and the trustee of the trust makes a timely ESBT election for the trust.

Section 1.1361-1(m)(1)(iv) provides that an ESBT does not include (A) any qualified subchapter S trust (as defined in section 1361(d)(3)) if an election under section 1361(d)(2) applies with respect to any corporation the stock of which is held by the trust; (B) any trust exempt from tax or not subject to tax under subtitle A; or (C) any charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)).

Section 1.1362-4(b) provides, in relevant part, that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the

terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination of the election was inadvertent.

Section 1.1362-4(f) provides, in relevant part, that the status of the corporation after the terminating event and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination relief may be granted retroactively for all years for which the terminating event is effective, in which case the corporation is treated as if its election had not terminated.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that the failure to file QSST elections for Trust 1 and Trust 2 caused a termination of X's S corporation election on Date 5. Further, we conclude that the failure to file ESBT elections for Trust 1 and Trust 2 effective Date 7, would have caused X's S corporation election to terminate effective Date 7 had X's S corporation election not previously terminated on Date 5.

We further conclude that the termination of X's S election on Date 5 was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 5 and thereafter, provided that X's S election is valid and not otherwise terminated under § 1362(d).

This letter ruling is subject to the following conditions: No later than 120 days from the date of this letter: (1) the beneficiaries of Trust 1 and Trust 2 must file QSST elections for Trust 1 and Trust 2 effective Date 4; and (2) the trustee and beneficiaries of Trust 1 and Trust 2 must file ESBT elections pursuant to § 1.1361-1(j)(12)(ii) effective Date 7. A copy of this letter ruling should be attached to these elections.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation or Trust 1 and Trust 2's eligibility as QSSTs or ESBTs.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalties of perjury statement

executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Joy C. Spies

Joy C. Spies
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes